
**Financial Institutions &
Insurance Committee**

HB 1923

Brief Description: Authorizing the creation of certified capital companies to promote investment in start-up and emerging Washington businesses.

Sponsors: Representatives P. Sullivan, Haler, Pettigrew, Walsh, Morrell, Strow, Kilmer, Kessler and Simpson.

Brief Summary of Bill

- Provides for the creation of capital companies to promote investment in small businesses.
- Allows tax credits to insurance companies for qualified investments in certified capital companies.

Hearing Date: 2/24/05

Staff: Christopher Abbott (786-7119).

Background:

Some states, including Louisiana, New York, and Missouri, as well as the District of Columbia, have authorized the creation of certified capital companies (CAPCOs) which provide venture capital to small businesses in those states. The CAPCOs make direct financial investments into small businesses and work with entrepreneurs to grow these businesses. Additional capital may be attracted to these small businesses because of the CAPCOs' initial investments, thus leveraging the original dollars.

Investments in CAPCOs are made attractive to insurance companies by allowing insurance companies investing in CAPCOs to take a premium tax write-off, spread out over time, for qualified investments. In Washington, all insurers except title insurers pay to the state treasurer, through the insurance commissioner, a two percent tax on premiums.

Summary of Bill:

A new chapter is created in Title 48 pertaining to CAPCO investments. A certified capital company or CAPCO is defined as:

1. a partnership, corporation, trust, or limited liability company, organized on a for-profit basis, which has its principal office located in, or is headquartered in, Washington;

2. having as its primary business activity the investment of cash in qualified businesses; and
3. certified by the Office of the Insurance Commissioner (OIC) as meeting the requirements of this new chapter.

A "qualified business" for purposes of CAPCO investment must be independently owned and operated and meet several requirements. First, it must be headquartered in Washington, have its principal business operation here, have at least 50 percent of its employees in the state, there must be a reasonable expectation that it will remain in Washington for at least three years after the qualified investment, and the qualified business must spend substantially all of the investment within this state. To be "qualified" the business must be a small business as defined in the Regulatory Fairness Act which requires that the business be owned and operated independently from other businesses and have 50 or fewer employees. There are certain businesses and professions which do not qualify, including doctors, lawyers, accountants, banking, insurance, and real estate development. Generally, it is the nature and size of the business at the time that it is first classified as a qualified business that is determinative of whether it can continue to receive qualified investments. An exception to this is made if the business relocates out of state or does not expend substantially all of the investment in this state, in which case it could not receive further qualified investments.

Insurers are allowed a credit against their premium tax in an amount equal to one hundred percent of their investment of certified capital in a certified capital company. The total amount of certified capital for which tax credits may be allowed is \$100 million. The total premium tax credit taken statewide each year cannot exceed \$10 million. No credits are allowed until 2008 for the first \$50 million and until 2009 for the next \$50 million. Ten percent of the credit is allowed to be taken in the taxable year in which the investment is allocated, and in each of the next nine years.

Decertification of a CAPCO causes the disallowance and the recapture of the premium tax credit together with interest, but not penalties. The amount of the disallowance depends upon when the decertification occurs. There are also provisions which preclude the tax credit from being taken if the insurer, individually or through its affiliates, manages or controls the CAPCO.

The OIC is authorized to make rules governing the application procedure to become a CAPCO. Certain parameters are set forth in the bill with respect to what is required, including the payment of a nonrefundable application fee of \$7500 and specified capitalization requirements.

Any offering materials put forth by the CAPCO is required to include specific language indicating that by certifying the CAPCO the state is not endorsing it and is not liable for damages or losses that an investor may sustain.

To continue to be eligible for certification, a CAPCO must make qualified investments of at least 25 percent within 2 years of the allocation date and 50 percent within five years of the allocation date. A CAPCO is required to notify the Insurance Commissioner before investments are made so that the commissioner may determine whether the business is "qualified". While a CAPCO may place capital in other than qualified businesses, if it has not placed 100 percent in qualified investments within 10 years the CAPCO shall no longer be permitted to receive management fees.

There are specific reporting requirements with which a CAPCO must comply. These requirements include disclosure of : the certified investors from whom the certified capital was

received, including insurance tax identification number; the amount of certified capital; all qualified investments and whether any of these were placed in distressed rural or urban areas; audited financial statements. An annual fee of \$500 is also required.

A CAPCO may make qualified distributions at any time. Qualified distributions include reasonable costs of formation, management fees, and fees for professional services. Other distributions can only be made if the aggregate cumulative amount of all qualified investments equals or exceeds 100% of its certified capital or it must receive written permission from the insurance commissioner.

The CAPCOs are subject to an annual review by the OIC. Once a CAPCO has invested an amount cumulatively equal to 100 percent of its certified capital in qualified investments, and has met all other requirements, it is no longer subject to regulation by the OIC. Certification can be revoked for any material representation or if the application materially violates any of the OIC's requirements.

The OIC is to report to the legislature and the governor on or before June 1st of each year beginning in 2007.

Appropriation: None.

Fiscal Note: Requested on February 18, 2005.

Effective Date: The bill contains an emergency clause and takes effect July 1, 2005.